COUNCIL AGENDA: 03-27-12

ITEM: 4.4



Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia

Julia H. Cooper

SUBJECT: SEE BELOW

DATE: March 8, 2012

Approved



Date

3-15-12

COUNCIL DISTRICT: 5 SNI AREA: MAYFAIR

SUBJECT:

APPROVAL OF THE ISSUANCE OF TAX-EXEMPT MULTIFAMILY HOUSING REVENUE BONDS, LOAN OF BOND PROCEEDS AND RELATED DOCUMENTS FOR THE MAYFAIR COURT APARTMENTS AND APPROVAL OF CAPITALIZION OF ACCRUED INTEREST ON THE CITY LOAN AND A CHANGE IN AFFORDABILITY TARGETING

RECOMMENDATION

- (a) Adopt a resolution of the City Council in connection with the issuance of Multifamily Housing Revenue Bonds:
 - (1) Authorizing the issuance of tax-exempt multifamily housing revenue bonds in two series designated as "City of San José Multifamily Housing Revenue Bond (Mayfair Court Apartments), Series 2012B-1 and Series 2012B-2" in an aggregate principal amount not to exceed \$22,000,000 (collectively, the "Bonds");
 - (2) Approving a loan of Bond proceeds to San Jose Pacific Associates, LP, a California Limited Partnership created by Pacific West Communities, Inc. and USA Multifamily Development, Inc., to finance the construction of the Mayfair Court Apartments located at 65 McCreery Avenue in San José (the "Project");
 - (3) Approving in substantially final form an Indenture of Trust, a Loan Agreement and Regulatory Agreement and Declaration of Restrictive Covenants (the "Documents"); and
 - (4) Authorizing and directing the City Manager, Acting Director of Finance, and Director of Housing, or their designees, to execute and, deliver these Documents and other related Bond documents as necessary.
- (b) Adopt a resolution of the City Council in connection with the City's existing loan for the Project (the "City Loan"):
 - (1) Approving the payment of the annual Bond monitoring fee of approximately \$27,500 in two parts: (i) \$7,500 to be paid on par with the Bond debt service and (ii) the remaining amount of the fee, approximately \$20,000, to be paid as a permitted expense after debt service.

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(2) Approving an increase in affordability targeting for 14 units in the Project currently restricted to households with incomes no greater than 50% of Area Median Income ("AMI") to households with incomes no greater than 40% of AMI.

Approving the capitalization of up to \$926,000 in acquisition interest accrued on the City Loan and up to \$626,362 in anticipated construction period interest, with such capitalized amounts to be repaid from residual receipts after payment of Bond debt service following the construction and lease up of the Project.

OUTCOME

Approval of the recommended actions will enable the issuance of multifamily housing revenue bonds for the purpose of constructing a 93-unit rental apartment project, composed of 92 units that will be affordable for a period of at least 55 years and one manager's unit that will be unrestricted. These apartments will serve very low- and extremely low-income households with current annual incomes between \$28,350 and \$52,500.

EXECUTIVE SUMMARY

In accordance with the requirements under the City's Policy for Issuance of Multifamily Housing Revenue Bonds, Pacific West Communities, Inc. and USA Multifamily Development, Inc. (collectively, the "Developer") have requested that the City issue tax-exempt multifamily housing revenue bonds, in an aggregate amount not to exceed \$22,000,000, the proceeds of which will be loaned to San Jose Pacific Associates, L.P., a California limited partnership (the "Borrower"). The Bonds, to be issued in two series, will be non-rated, non-credit enhanced and structured as a private placement with JPMorgan Chase Bank, N.A. as the initial purchaser. The proceeds of the loan, together with other funds, will be used by the Borrower to finance the construction of a 93-unit rental apartment housing project to be known as Mayfair Court Apartments (the "Project"). The Project, formerly known as the McCreery Courtyard Apartment Project, will consist of 92 units that will be affordable for at least 55 years and one (1) manager's unit that will be unrestricted. The affordable units are comprised of 56 two-bedroom units and 36 three-bedroom units.

Additionally, the subordinate loan of \$6,750,000 made by the City on September 30, 2008, to the Project from 20% housing set-aside tax increment funds and disbursed on November 10, 2008, to acquire the Project site, will be converted to a construction/permanent loan with certain proposed changes to its affordability requirements and repayment terms.

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BACKGROUND

Borrower. The Borrower, San Jose Pacific Associates, L.P., is a California limited partnership. The Borrower will consist of: (1) TPC Holdings V, LLC dba TPC Idaho Holdings, LLC, Inc. and USA Grove Station, Inc. a California corporation, as Administrative General Partners, (2) CVCAH Mayfair, LLC, an affiliate of Central Valley Coalition for Affordable Housing, a California nonprofit public benefit corporation, as the Managing General Partner, and (3) WNC & Associates, Inc. or an affiliate thereof, as the tax credit investor limited partner.

The Developer has requested that the City issue the Bonds for the purpose of loaning the Bond proceeds to the Borrower. The proceeds of the Bonds, together with other funds, will be used by the Borrower to finance the construction of the Project.

Project Overview. The Project involves the construction of 93 two-bedroom and three-bedroom apartment units. Upon completion of the Project, 50 percent of the affordable units (46 units) will be initially rented to individuals and families with incomes that do not exceed 30 percent of the area median income ("AMI"); 25 percent of the affordable units (23 units) will be rented to individuals and families with incomes that do not exceed 40 percent of AMI; 25 percent of the units (23 units) will be rented to families with incomes that do not exceed 50 percent of AMI. One of the Project's 93 units is an unrestricted manager's unit. The rental restrictions for the Project will remain for a period of 55 years and conform to the City's rental affordability requirements.

City Loan for the Project. On September 30, 2008, Council adopted Resolution No. 74607 approving a funding commitment for a land acquisition/construction/permanent loan (the "City Loan") in the amount up to \$7,900,000 for the development of the Project. The funding source of the City Loan was 20% housing set-aside tax increment funds. The acquisition loan was funded on November 10, 2008, enabling the Developer to acquire the Project site.

City as Issuer of Multifamily Housing Bonds. The City's Policy for Issuance of Multifamily Housing Revenue Bonds (the "City Policy") requires that if the Housing Department makes a project loan, the City must be the issuer of tax-exempt multifamily housing revenue bonds for the purpose of lending the bond proceeds to the project.

On December 14, 2010, utilizing an exception to the City Policy, Council authorized the California Statewide Communities Development Authority ("CSCDA") to issue bonds for the Project due to CSCDA's access to then more cost-effective NIBP financing terms available under the Federal Housing and Economic Recovery Act of 2008. CSCDA received a private activity bond allocation in January 2011. The Governor's temporary suspension of the State's Housing and Community Development MHP program in January 2011 prevented CSCDA from issuing bonds for the Project as originally planned. Subsequently, long-term tax-exempt rates declined to levels below those available with the NIBP bond program. The Developer abandoned the CSCDA financing and has requested the City to be the issuer.

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Sources of Project Funding. The Bonds will be issued in two series in an aggregate principal amount of \$22,000,000. During construction, each series of Bonds will be structured as a variable rate obligation. After construction and lease up (the "permanent phase"), one of the series will be repaid in full and other series will be converted to a fixed-rate obligation. Bond proceeds will fund a portion of the total Project costs, which are estimated to be \$39,782,214. The estimated sources of funding for the Project's construction phase and permanent phase are as follows:

City of San José Mayfair Court Apartments Plan of Finance – Sources of Funding⁽¹⁾

Source Construction		Permanent		
Bond Proceeds	\$	22,000,000	\$	5,220,000
City Loan		6,750,000		6,750,000
State of California MHP Loan		-		9,200,000
State of California Proposition IC Funds (Infill Loan)		3,720,000		3,720,000
Tax Credit Equity		6,386,214		13,339,852
Deferred City Loan Interest		926,000		1,552,362
Total	\$	39,782,214	\$	39,782,214

⁽¹⁾ Estimated as of the date of this report. The actual amounts may vary from these estimates.

Financing History of Project – Key Dates. Multiple TEFRA (Tax Equity and Fiscal Responsibility Act) Hearings were held for the Project. If a bond issue does not occur within twelve months of a TEFRA Hearing, a subsequent hearing must be held. On November 12, 2008, the City's Director of Finance held a TEFRA Hearing, pursuant to Municipal Code Section 5.06.430, regarding the issuance of tax-exempt multifamily housing revenue bonds by the City in an amount not to exceed \$25,000,000 to finance the construction of the Project. On December 14, 2010, Council held a second TEFRA Hearing to receive public comment regarding the issuance of bonds in an amount not to exceed \$25,000,000 by CSCDA for the Project. CSCDA did not issue the bonds. On September 14, 2011, the City's Acting Director of Finance, pursuant to Municipal Code Section 5.06.430, held a third TEFRA hearing regarding the issuance of taxexempt multifamily housing revenue bonds in an amount not to exceed \$24,000,000 to finance the construction of the Project. On September 16, 2011, the Director of Housing submitted an application to CDLAC for an allocation of up to \$22,000,000 in private activity bonds for the Project, pursuant to the Joint Authority of the Directors of Housing and Finance under San José Municipal Code Section 5.06.425. On November 15, 2011, at the request of the Borrower, the City withdrew that application, which was resubmitted to CDLAC on November 18, 2011. On January 18, 2012, the City received a private activity bond allocation of \$22,000,000 from CDLAC as requested.

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On February 1, 2012, the Redevelopment Agency of the City of San José was dissolved and all assets of the 20% Housing Program, including fully disbursed loans, were transferred to the City pursuant to state legislation (ABX1 26).

ANALYSIS

This portion of the report is divided into several sections to address the items in staff's recommendation to proceed with the Project financing. These sections include descriptions of the financing structure, financing documents, existing City funding commitment, financing team participants, and financing schedule.

Bond Financing Structure

Overview of the Multifamily Bond Financing

<u>General</u> Multifamily housing financing typically involves the issuance of tax-exempt bonds on behalf of private developers of qualifying affordable rental apartment projects. The City issues the bonds and loans the proceeds to the developer/borrower. The advantages of tax-exempt financing to developers include: below-market interest rates and low-income housing tax credits – features not available with a conventional multifamily housing mortgage loan. The bonds are limited obligations of the City, payable solely from loan repayments by the borrower.

Requirements for Tax-Exemption For a multifamily housing revenue bond to qualify for tax-exemption, federal law generally requires that one of two restrictions apply: either (1) at least 20% of the units in the housing development must be reserved for occupancy by individuals and families with incomes of 50% or less of area median income or (2) at least 40% of the units must be reserved for occupancy by individuals and families with incomes of 60% or less of area median income. This second restriction will be incorporated into the Regulatory Agreement for the Bonds. Further, in consideration of the City Loan, the Project will be subject to the deeper affordability requirements described in the Background section above.

Structure of the Bonds

<u>Private Placement Structure</u> The Bonds will be non-rated, non-credit enhanced and structured as a private placement with JPMorgan Chase Bank, N.A. ("JPM." or "Private Placement Purchaser") as the initial private placement purchaser. Pursuant to the City's policies regarding non-credit enhanced notes, the Private Placement Purchaser will sign an Investor's Letter acknowledging that it is a "qualified institutional buyer" or an "accredited investor," that is, a large institutional investor who understands and accepts the risks associated with unrated Bonds secured solely by the Project rents. If the Private Placement Purchaser wishes to transfer the Bonds, the new Bondholder must sign and

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deliver a similar Investor's Letter to the Trustee. The Bonds can only be transferred in whole.

Principal Amounts and Terms The Bonds will be issued in two series in an aggregate principal amount not to exceed \$22,000,000. The Series 2012B-1 Bond (the "Series 2012B-1 Bond") will be issued in the approximate amount of \$5,220,000 and will have a final maturity of approximately 32.5 years. The Series 2012B-2 Bond (the "Series 2012B-2 Bond") will be issued in the approximate amount of \$16,780,000 and have a final maturity of approximately 2.5 years. The final principal amounts of the Series 2012B-1 Bond and Series 2012B-2 Bond may change until the closing date, so long as the aggregate amount of Bonds does not exceed \$22,000,000. After the Project is completed and leased up and conversion to the permanent loan phase occurs, which is expected to occur no later than 2.5 years after Bond issuance (the "Conversion Date"). the Borrower will use tax credit equity funds and the proceeds of a Housing and Community Development MHP loan to repay the Series 2012B-2 Bond in full. In addition, the Series 2012B-1 Bond will convert to a fixed rate obligation that will amortize on a 30-year basis over the remaining 30-year term. The Series 2012B-1 Bond will be subject to prepayment (a) prior to 15 years following the Conversion Date, subject to a "yield maintenance" payment by the Borrower, (b) after 15 years following the Conversion Date, subject to a 1% prepayment premium, and (c) during the 90 day period prior to Bond maturity without premium.

<u>Interest Rates</u> During the construction period, both the Series 2012B-1 Bond and Series 2012B-2 Bond will pay interest-only at a variable rate equal to the one-month LIBOR Index plus a margin of 2.00% per year. After the Conversion Date, the interest on the Series 2012B-1 Bond will convert to a fixed rate that is estimated to be approximately 4.85% based on current market conditions.

Financing Documents

The following is a brief description of each document Council is being asked to approve and authorize the execution of. Copies of these documents will be available in the City Clerk's Office on or about March 15, 2012.

<u>Indenture of Trust</u> The Bonds will be issued under an Indenture of Trust (the "Indenture") among the City, JPM, as initial bondholder representative, as funding lender, and U.S. Bank National Association, as trustee (the "Trustee"). The Indenture is executed by the Acting Director of Finance, Acting Assistant Director of Finance, or other authorized officers on behalf of the City, and attested by the City Clerk. Pursuant to the Indenture, the Trustee is given the authority to receive, hold, invest, and disburse the Bond proceeds and other funds established under the Indenture; to authenticate the Bonds; to apply and disburse payments to

¹ A yield maintenance payment will be in amount that assures JPM of the return it would have received for 15 years had the prepayment not occurred.

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the Bondholder; and to pursue remedies on behalf of the Bondholder. The Indenture sets forth the guidelines for the administration, investment and treatment of investment earnings generated by each fund and account, and restrictions relating to any subsequent transfer of the Bonds. The Loan Agreement (described below) obligates the Borrower to compensate the Trustee for services rendered under the Indenture.

Loan Agreement There is also a loan agreement (the "Loan Agreement") among the City, JPM and the Borrower. The Loan Agreement is executed by the Acting Director of Finance, Acting Assistant Director of Finance or other authorized officer on behalf of the City. The Loan Agreement provides for the loan of the Bond proceeds to the Borrower for construction and permanent financing for the Project and for the repayment of such loan by the Borrower. The loan is evidenced by two notes (the "Loan Notes") in the same principal amounts as the Series 2012B-1 Bond and Series 2012B-2 Bond. One Loan Note will be repaid in full at the Conversion Date contemporaneously with the repayment of the Series 2012B-2 Bond; the other Loan Note will remain outstanding in an amount that corresponds to the outstanding principal amount of the Series 2012B-1 Bond. The City's rights to receive payments under the Loan Notes will be assigned to the Trustee, along with certain other rights under the Indenture, Loan Agreement and Bonds; however, certain reserved rights have been retained by the City, such as the City's right to indemnification.

Regulatory Agreement and Declaration of Restrictive Covenants Additionally, there is an agreement (the "Regulatory Agreement") among the City, the Trustee, and the Borrower that contains certain covenants and restrictions regarding the Project and its operations intended to assure compliance with the Internal Revenue Code of 1986. The Regulatory Agreement is executed by the Acting Director of Finance, Acting Assistant Director of Finance and Director of Housing, or other authorized officers on behalf of the City. The Regulatory Agreement restricts the rental of Project units (except for one manager's unit) to very low-income and extremely low-income residents for a period of at least 55 years as previously described.

Financing Team Participants

The financing team participants consist of:

City's Financial Advisor: Ross Financial

Bond Counsel: Jones Hall, A Professional Law Corporation

• Trustee: U.S. Bank National Association

Private Placement Purchaser: JPMorgan Chase Bank, N.A.

All costs associated with the financial advisor, bond counsel and trustee are contingent upon the sale of the Bond and will be paid from Bond proceeds and/or Borrower equity.

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Financing Schedule

The current proposed schedule is as follows:

9	Council Approval of Bond Documents	March 27, 2012
•	Bond Pre-Closing	April 10, 2012
•	Bond Closing	April 12, 2012
0	Anticipated CDLAC Deadline for Bond Closing	April 17, 2012

City Subordinate Loan

On September 30, 2008, Council authorized a \$7,900,000 acquisition/construction/permanent loan for the Project to be funded from 20% housing set-aside funds. On November 10, 2008, \$6,750,000 of the authorized City loan (the "City Loan") was disbursed to enable the Developer to acquire the Project site. The remaining \$1,150,000 that was previously authorized is no longer eligible to be disbursed and no other funds from the City, except for Bond proceeds, will be disbursed for the Project.

The City now manages the City Loan as a housing asset. Pursuant to AB1X 26, the redevelopment dissolution legislation, the management of housing assets of the former Redevelopment Agency by the City is not in its capacity as Successor Agency and is not subject to review by the Oversight Board created to oversee the dissolution of the former Redevelopment Agency.

The City will convert the \$6,750,000 City Loan to a construction/permanent loan in connection with the Bond closing anticipated in mid-April 2012. Due to funding delays of more than one year, approximately \$926,000 of acquisition loan period interest on the City Loan will have accrued – significantly more than originally anticipated. Thus, up to \$926,000 will be capitalized and added to the City Loan balance at conversion to a construction loan. Interest on the City Loan will continue to accrue during the Project's construction and lease-up period in an expected amount of \$626,362. An amount up to \$626,362 will also be capitalized and added to the City Loan balance when it converts to a permanent loan. Accordingly, a total of up to \$1,552,362 of accrued interest will be capitalized by the time the Project is constructed and leased. The City Loan, including the capitalized interest, will be paid from the Project's residual receipts, following repayment of Bond debt service and other required expenses. These capitalizations will not involve the disbursement of any additional City funds

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As consideration for capitalizing accrued interest on the City Loan during the acquisition period, the Borrower has agreed to increase the affordability for 14 units currently set aside for households with incomes that do not exceed 50% of AMI, provided that such a change to the affordability is approved by the Council. With Council approval, those 14 units will become restricted to households with incomes no greater than 40% of AMI, with corresponding reductions in rents.

<u>Affordability</u>	Current <u>Affordability Mix</u>	Proposed <u>Affordability Mix</u>
30% of AMI	46	46
40% of AMI	9	23
50% of AMI	37	23
Unrestricted (Mgr. Unit)	1	<u>1</u>
Total Units	93	93

City Bond Monitoring Fee

The City Bond Monitoring Fee, while not directly related to the City Loan, is typically collected under the Regulatory Agreement and Loan Agreement executed as part of the bond issue. Under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, the annual fee is equal to the greater of one-eighth of a point (0.125%) of the original principal amount of the Bonds, with a minimum fee of \$7,500. Based on the formula and an initial Bond size of \$22,000,000, the annual fee will be \$27,500. Under City Policy, this fee is paid by the Borrower on a parity with loan repayments used to pay bond debt service unless otherwise approved by the City. For the Project, Staff recommends that the annual bond monitoring fee be bifurcated into two parts: (1) \$7,500 paid on a parity with loan repayments that will repay the Bonds and (2) \$20,000 paid after those loan repayments. This bifurcated approach allows for a larger permanent bond amount that offsets the effect of: (a) reduced rents arising from the increase in units restricted to households earning no more than 40% of AMI and (b) the City's inability to increase the City Loan amount by the \$1,150,000 originally authorized by Council. This bifurcation will be documented in the Bond Loan Agreement and the Bond Regulatory Agreement and in City Loan documentation.

It should be noted that while bifurcation of the bond fee is allowed by the Policy, it is not a practice that Housing or Finance Department would recommend in all cases. In this case, the City's original commitment to the project was eliminated due to the passage of AB IX 26 which eliminated Redevelopment and the City's ability to provide the additional Low- and Moderate-Income Housing funds for the project.

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EVALUATION AND FOLLOW-UP

This Memorandum presents the set of recommendations related to Council's approval of the issuance of the Bonds for the Mayfair Court Apartments and requires no follow-up to Council. Once the Bonds close, anticipated to be in mid-April 2012, and the construction of the Project commences, the Housing Department will provide updates in its Quarterly Construction Reports to Council.

PUBLIC OUTREACH/INTEREST

Criterion 1: Requires Council action on the use of public funds equal to \$1 million or greater. (Required: Website Posting)
Criterion 2: Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. (Required: E-mail and Website Posting)
Criterion 3: Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. (Required: E-mail, Website Posting, Community Meetings and Notice in appropriate newspapers)

This action does not meet any of the above Criteria. The method of notifying the community of the City's intent to issue a tax-exempt private activity note is for the City Council to hold a Tax Equity and Fiscal Responsibility Act (TEFRA) Hearing. The TEFRA Hearing was held on September 14, 2011, before the Acting Director of Finance. The public hearing notice for the September 14, 2011, hearing was published in the *San José Mercury News* on August 30, 2011. This Memorandum will also be posted on the City's website in advance of the March 27, 2012 meeting.

COORDINATION

This report has been prepared by the Finance Department in coordination with the Housing Department and the City Attorney's Office.

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FISCAL/POLICY ALIGNMENT

This action is consistent with the City's 2007-2012 Five-Year Housing Investment Plan, adopted by Council on June 12, 2007, to increase the supply of affordable housing, and with the City's Consolidated Plan 2010-2015 to provide housing units for very low- and extremely low-income households.

COST SUMMARY/IMPLICATIONS

All issuance costs will be paid from Bond proceeds and/or Borrower equity. The Bonds are tax-exempt obligations secured by mortgage loans payable from Project revenues. No payment of the Bonds will be made from, or guaranteed through, the general taxing power of the City or any other City asset. Based on an aggregate initial Bond par of \$22,000,000, the City will receive an upfront issuance fee of approximately \$80,000. The City will also receive an annual fee for monitoring the Bonds and the Regulatory Agreement. Under the City's Policy for the Issuance of Multifamily Housing Revenue Bonds, the annual fee is equal to the greater of one-eighth of a point (0.125%) of the original principal amount of the Bonds or a minimum fee of \$7,500. Based on the formula and an initial Bond size of \$22,000,000, the annual fee will be \$27,500. A portion of this annual fee will be paid by the Borrower on a parity with the repayment of loans that fund debt service on the Bonds; the other portion will be paid after such loan repayments

No appropriation of funds is required at this time. Compensation for the financing team participants (financial advisor, bond counsel, and trustee), as well as the costs of the financing, are contingent on the sale of the Bonds and will be paid from Bond proceeds and/or Borrower equity.

CEQA

Mitigated Negative Declaration and addenda thereto, File No. PDC04-088.

JULIA H. COOPER
Acting Director of Finance

/s/ LESLYE CORSIGLIA Director, Housing Department

For questions, please contact Arn Andrews, Acting Assistant Director of Finance at (408) 535-7041.